

## Note

# The 21st Century Employer's Catch-22: *Cotran v. Rollins Hudig Hall International, Inc.* and the Consequences of the Fair Credit Reporting Act

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PROVIDING EMPLOYEES WITH a workplace free from harassment, discrimination, and criminal acts is a primary concern of both employers and their legal counsel across the nation.<sup>1</sup> When faced with allegations of employee misconduct, employers are wise to take swift action.<sup>2</sup> However, in many instances it is impossible to definitively prove that an accused engaged in the alleged misconduct, even after the most thorough investigation. In such situations, if the employer chooses to take adverse employment action against the accused, the accused can easily launch a counterattack by means of a lawsuit against his or her former employer<sup>3</sup> for wrongful termination,<sup>4</sup> defamation,<sup>5</sup> or even deprivation of constitutional rights.<sup>6</sup> The number of

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\* Class of 2001. Dedicated to Eugene and Susan H. Majeski and Lawrence Handelman for their continuing support and encouragement.

1. See Patricia Jacobus, *Turning the Tables*, S.F. DAILY J., Sept. 7, 1999, at 1, 7.

2. See Michael Starr, *Alleged Harassers Strike Back! Risks to Employers Who Overreact to Complaints*, 12 NO. 10 CORP. COUNS. 1, Mar. 1998, at 1.

3. See Michael Delikat, *Developments in Sexual Harassment Law*, 630 PLI/Lit 283, 414 (June 2000).

4. An employer may be liable for the tort of wrongful termination if the employer terminates an employee "for a reason that contravenes fundamental public policy as expressed in a constitutional or statutory provision." *Turner v. Anheuser-Busch, Inc.*, 876 P.2d 1022, 1030 (Cal. 1994).

5. To bring a claim for defamation against an employer, the plaintiff must establish that: (1) a "communication" was made which was "defamatory" in nature; (2) the communication was published to a third party or parties; (3) the communication referred to the plaintiff; (4) the third party would understand the communication to be defamatory to the plaintiff; and (5) the plaintiff was injured accordingly. See, e.g., *Quinones v. United States*,

lawsuits brought by employees claiming to have been falsely accused of misconduct continues to rise.<sup>7</sup>

In 1998, the California Supreme Court decided a landmark case which relieved California employers of much of the burden of justifying the termination of employees accused of misconduct.<sup>8</sup> In *Cotran v. Rollins Hudig Hall International, Inc.*,<sup>9</sup> the court held that regardless of the ultimate truth of the allegations, employers may escape liability for taking adverse employment actions if, after conducting an "adequate investigation" of the misconduct, they came to the good faith belief that the misconduct more likely than not occurred.<sup>10</sup>

After *Cotran*, the focus of "fight back" litigation brought by terminated employees shifted from the grounds for dismissal to the adequacy of the employer's investigation of the alleged misconduct.<sup>11</sup> To shield themselves from liability, employers now must ensure that the investigations they undertake are both thorough and unbiased. The most effective method of doing so is to utilize outside investigators unassociated with both the employees and workplace dynamics involved and thereby able to conduct a neutral investigation of the misconduct.<sup>12</sup>

While employers experienced temporary relief from the burden of justifying termination decisions after *Cotran*, the California Supreme Court's efforts have been impaired by an opinion letter<sup>13</sup> re-

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492 F.2d 1269, 1274 (3d Cir. 1974). Furthermore, the offending communication must have been made with malice, defined as "a *wrongful* act done intentionally, without just cause or excuse." *Id.* at 1275.

6. See *Johnson v. City of Menlo Park*, No. C-98-2858 VRW, 1999 WL 551241, at \*2-10 (N.D. Cal. July 23, 1999) (holding that defendant employer's investigation and termination of plaintiff did not violate plaintiff's: (1) Fourth Amendment right to be free from unreasonable search and seizure; (2) Fourteenth Amendment right to substantive due process; (3) Fourteenth Amendment rights not to be deprived of liberty without due process of law; or (4) First Amendment right to freedom of expression).

7. See Starr, *supra* note 2, at 1.

8. See *Cotran v. Rollins Hudig Hall Int'l, Inc.*, 948 P.2d 412 (Cal. 1998); see also Thomas P. Klein & Richard H. Rahm, *Despite Cotran, Employers May Need to Prove Misconduct Charges*, THE RECORDER, EMPLOYMENT LAW SUPP., May 1999, at S27.

9. 948 P.2d 412 (Cal. 1998).

10. See *id.* at 422.

11. See Jacobus, *supra* note 1, at 7.

12. See Eric Mason, *Employers Should Keep Out of Sexual Harassment Investigations*, THE RECORDER, EMPLOYMENT LAW SUPP., May 1999, at S32-S34.

13. An opinion letter is an informal statement interpreting ambiguous statutory provisions made by a government agency in response to an inquiry from the public. See Bruce E. Yannett, *FTC Applies FCRA to Firms*, NAT'L L.J., Feb. 14, 2000, at C6. As one court recently noted in dicta, opinion letters do not have the force of law that formal regulations do. See *Robinson v. Time Warner, Inc.*, 187 F.R.D. 144, 148 n.2 (S.D.N.Y. 1999). While opinion letters are not the "law," ignoring them is perilous. See Yannett, *supra*, at C6. If noncompli-

leased by the Federal Trade Commission ("FTC") in April of 1999.<sup>14</sup> The opinion letter, known as the "Vail Letter," interprets 1996 amendments to the Fair Credit Reporting Act<sup>15</sup> ("FCRA").

The FCRA is "the federal law that governs the acquisition and use of virtually any type of information gathered by third parties on job applicants and employees."<sup>16</sup> Congress enacted the FCRA to protect consumers from inaccurate and obsolete credit information that could lead to the unwarranted denial of credit, insurance, and employment.<sup>17</sup> While Congress originally passed the FCRA "to protect the privacy of credit report information and to attempt to guarantee the accuracy of information supplied by credit bureaus,"<sup>18</sup> the 1996 amendments have been interpreted to make the FCRA applicable to "consumer reports" and "investigative consumer reports" of job applicants or employees, including those that contain absolutely no credit-related information.<sup>19</sup> Thus, the title of the FCRA is misleading because it contains the phrase "credit reporting," when it actually applies to a much broader spectrum of reports gathered by employers.<sup>20</sup>

The 1996 amendments to the FCRA require that an employer both provide notice and obtain an employee's consent before obtaining a "consumer report" pertaining to him or her.<sup>21</sup> It also requires employers to make a full, unedited disclosure of the contents of the report to the employee after it is received.<sup>22</sup> In April of 1999, an FTC attorney released the Vail Letter, which stated that the procedural regulations of the amended FCRA apply to investigations of employee misconduct undertaken by a third party investigator for an employer.<sup>23</sup> The FTC thereby created a Catch-22 for employers: If an

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ance with an opinion letter is challenged in court, and the court agrees with the agency's stance on the statutory interpretation at issue, it could lead to serious statutory penalties for the attorneys, including punitive damages. *See id.*

14. Letter from Christopher W. Keller, Attorney, Federal Trade Commission, to Judy A. Vail, Esq. (Apr. 5, 1999), <http://www.ftc.gov/os/statutes/fcra/vail.htm> [hereinafter Vail Letter].

15. 15 U.S.C. §§ 1681, 1681a-1681u (1994 & Supp. IV 1999).

16. Littler Mendelson, *FTC Determines that FCRA Applies to Workplace Sexual Harassment Investigations*, 12 CAL. EMP. L. MONITOR 3, 3 (1999).

17. *See* Meredith J. Fried, *Helping Employers Help Themselves: Resolving the Conflict Between the Fair Credit Reporting Act and Title VII*, 69 FORDHAM L. REV. 209, 219-20 (2000).

18. Delikat, *supra* note 3, at 420.

19. *See id.*

20. *See id.*

21. *See* 15 U.S.C. § 1681b(b)(2)(A) (Supp. IV 1999); *see also* Delikat, *supra* note 3, at 422.

22. *See* 15 U.S.C. § 1681b(b)(3)(A).

23. *See* William L. Kandel, *Sexual Harassment*, 67 PLI/NY 75, 156 (1999).

employer wishes to utilize one of the most effective means of conducting an adequate investigation of alleged misconduct in the workplace—using a third party to handle the investigation—the employer must not only obtain the accused's consent, but also fully disclose the fruits of the investigation to the accused.<sup>24</sup> Congress could not have envisioned this expansive interpretation of the FCRA.<sup>25</sup>

Part I of this Note examines the *Cotran* decision, providing the relevant background. Part II discusses the adequate investigation standard introduced in *Cotran* and clarified in part by subsequent California case law. Part II also discusses the effect of *Cotran* on employment law in California. Part III introduces the FCRA and the Vail Letter. Part IV discusses the effect of the Vail Letter upon investigations of workplace misconduct. Part V explains why applying the notice, consent, and disclosure requirements of the FCRA contradicts the Act's statutory language and also fails to further the congressional purpose behind the Act. Part VI sets forth the various solutions suggested both by the FTC and members of Congress, who have currently proposed two amendments in the House of Representatives. Part VI also discusses why each of these solutions fail to satisfactorily resolve the conflict between the FCRA and efficient investigations of workplace misconduct.

Finally, Part VII concludes that while *Cotran* left several issues unresolved, its holding was an essential step toward helping employers successfully sustain their decisions to terminate. This Part argues that the FCRA's requirements should only apply to credit-related reports acquired by an employer used to make the initial decision to hire a prospective employee. If Congress wishes to provide protections to employees who are the subject of workplace investigations, it should do so in legislation unrelated to the FCRA. In the meantime, courts should interpret the FCRA narrowly and exclude from its coverage investigations of workplace misconduct conducted by third parties. Without the stringent requirements of the FCRA, employers in California and across the nation<sup>26</sup> will have the opportunity to conduct

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24. *See id.*

25. *See* Yannett, *supra* note 13, at C6.

26. The restrictions of the FCRA applied to the investigations of employee misconduct create difficulties for employers not only in California, but also across the nation due to the United States Supreme Court decision in *Faragher v. City of Boca Raton*, 524 U.S. 775, 792 (1998). *See* CURIALE DALLAVERSON HIRSCHFELD KELLY & KRAMER LLP, *Drafting an Effective Investigation Report: What Cotran and Ken Starr Taught Us*, 1999 LABOR & EMPLOYMENT LAW SYMPOSIUM 1, 2 [hereinafter 1999 LABOR & EMPLOYMENT LAW SYMPOSIUM]. In *Faragher*, the Court held that employers can avoid vicarious liability for sexual harassment of an

the most objective and thorough investigations to help rid their workplaces of illegal acts.

## **I. The Adequate Investigation Standard for Termination of Employment in California**

Credible and undisputed evidence of employee misconduct in the workplace constitutes good cause for termination so long as the termination is not based on impermissible considerations such as union membership, race, sex, age, or political affiliation.<sup>27</sup> However, California courts have been in conflict over whether allegations of misconduct, coupled with a good faith investigation of the allegations by the employer, are enough to constitute good cause for termination, regardless of whether or not the allegations can be proven true. As a result, a jurisdictional split arose in the California courts of appeal regarding the standard an employer must meet for a good cause<sup>28</sup> termination.<sup>29</sup>

Most employment relationships in California do not require good cause to terminate.<sup>30</sup> Unless a specified term of employment has been agreed upon, or an express agreement not to terminate without good cause has been made, an employee is employed "at will."<sup>31</sup> If an employee is employed at will, he or she is free to quit his or her employment at any time, and the employer may terminate the employment at any time for any reason.<sup>32</sup> While the statutory presumption of at will employment is strong in the absence of an express agreement other-

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employee if the employer exercises reasonable care to prevent and promptly correct sexual harassment and also if the plaintiff unreasonably fails to take advantage of any preventive or corrective procedures provided by the employer. See *Faragher*, 524 U.S. at 792. For further analysis of *Faragher*, see discussion *infra* notes 148-52, 163-64 and accompanying text. Together, *Faragher* (which applies nation-wide) and *Cotran* (which applies in California) "affirm the need for employers to implement effective workplace harassment policies and conduct thorough investigations into allegations of misconduct." 1999 LABOR & EMPLOYMENT LAW SYMPOSIUM, *supra*, at 2. *Cotran*, however, heightens the need for employers particularly in California to conduct thorough and objective investigations of alleged misconduct.

27. See *Pugh v. See's Candies, Inc.*, 171 Cal. Rptr. 917, 922 (Ct. App. 1981).

28. The definition of "cause" to terminate for purposes of this discussion applies only in the context of an implied contract to terminate only for good cause. See *Guz v. Bechtel Nat'l Inc.*, 100 Cal. Rptr. 2d 352, 365 (Ct. App. 2000).

29. See *Wilkerson v. Wells Fargo Bank*, 261 Cal. Rptr. 185 (Ct. App. 1989); *Pugh v. See's Candies, Inc.*, 171 Cal. Rptr. 917 (Ct. App. 1981); see also *Cotran v. Rollins Hudig Hall Int'l, Inc.*, 948 P.2d 412 (Cal. 1998).

30. See CAL. LAB. CODE § 2922 (West 1989).

31. See *id.*

32. See *Guz*, 100 Cal. Rptr. 2d at 364.

wise, it is subject to limitations.<sup>33</sup> Even in the absence of an express promise to terminate only for good cause, courts have been willing to hold that an "implied-in-fact" contract has been made whereby the employee may not be terminated except for good cause.<sup>34</sup> An implied-in-fact promise to terminate only for good cause can be established by evidence, for example, "of personnel policies or practices of the employer, the employee's longevity of service, actions or communications by the employer reflecting assurances of continued employment, and the practices of the industry in which the employee is engaged."<sup>35</sup>

If the parties agree to at will employment or the employee is unable to rebut the presumption of an at will relationship, then no cause of any kind is required to terminate.<sup>36</sup> If the parties expressly agree on the standard of proof for determining good cause to terminate, then that standard will prevail.<sup>37</sup> However, the conflict that arose in California courts concerns the proper standard for determining good cause in circumstances where the court finds an implied promise to terminate only for good cause.<sup>38</sup>

#### **A. Background: California Case Law Regarding the Evidentiary Standard Necessary to Constitute Good Cause to Terminate Employment**

In *Pugh v. See's Candies, Inc.*,<sup>39</sup> the First District Court of Appeal held that an employer is entitled to discretion when faced with allegations of misconduct by one of its employees.<sup>40</sup> In *Pugh*, a vice president of See's Candies ("See's") argued he had an implied contract to terminate only for good cause.<sup>41</sup> Pugh had worked at See's for thirty-two years and was fired for undisclosed reasons.<sup>42</sup> Pugh speculated that his termination was due to his objection to a union agreement that allowed See's to pay its seasonal employees a lower salary.<sup>43</sup> Pugh sued See's for wrongful termination.<sup>44</sup>

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33. *See id.*

34. *See id.* at 365.

35. *Pugh v. See's Candies, Inc.*, 171 Cal. Rptr. 917, 925-26 (Ct. App. 1981).

36. *See Guz*, 100 Cal. Rptr. 2d at 364.

37. *See id.* at 365.

38. *See Cotran v. Rollins Hudig Hall Int'l, Inc.*, 948 P.2d 412, 414 (Cal. 1998).

39. 171 Cal. Rptr. 917 (Ct. App. 1981).

40. *See id.* at 928.

41. *See id.* at 927.

42. *See id.* at 918, 919.

43. *See id.* at 920.

44. *See id.* at 918.

The court disagreed with Pugh and held that See's had legitimately exercised its managerial discretion in terminating his employment.<sup>45</sup> The court stated that the proper standard for determining whether an employer had wrongfully terminated an employee was whether a jury could find "a fair and honest cause or reason, regulated by good faith on the part of the party exercising the power."<sup>46</sup> This case established an objective, good faith standard for discharges based on employment contracts containing implied-in-fact promises to terminate only for good cause.<sup>47</sup>

Subsequently, in 1989, the Second District Court of Appeal, in *Wilkerson v. Wells Fargo Bank*,<sup>48</sup> set forth a conflicting standard for determining an employer's liability after terminating an employee based upon allegations of misconduct. In *Wilkerson*, Wells Fargo fired Wilkerson for allegedly personally benefiting from bank transactions.<sup>49</sup> Wilkerson denied the allegations and sued Wells Fargo for wrongful termination.<sup>50</sup> The court remanded the case for a determination of (1) whether there existed an implied contract to terminate only for good cause, and (2) whether Wilkerson's termination was supported by cause.<sup>51</sup> More significantly, the court held that in a case of employee misconduct, the employer had to prove that the misconduct actually occurred in order to justify the termination.<sup>52</sup> The court reasoned that regardless of good faith on the part of the employer, "an employer's belief is not a substitute for good cause. For that reason, the employer's broad latitude does not extend to being *factually* incorrect."<sup>53</sup> In cases of implied contracts to terminate only for good cause, where the employer claims that "the employee was discharged for specific misconduct, and the employee denies the charge, the question of whether the misconduct occurred is one of fact for the jury."<sup>54</sup>

Before the California Supreme Court addressed this issue, the majority of the California courts of appeal followed *Pugh*, finding that regardless of the truth of the allegations of misconduct, an employer could escape liability for wrongful termination as long as the em-

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45. *See id.* at 928. The court reversed a judgment of nonsuit for defendant and remanded the case for further consideration consistent with its holding. *See id.*

46. *Id.* (citation omitted).

47. *See id.*

48. 261 Cal. Rptr. 185 (Ct. App. 1989).

49. *See id.* at 187-88.

50. *See id.* at 188.

51. *See id.* at 193-94.

52. *See id.* at 192-93.

53. *Id.* at 192.

54. *Id.* at 192-93.

ployer acted in good faith.<sup>55</sup> However, until the California Supreme Court's landmark 1998 decision in *Cotran*, the conflict regarding the proper standard for determining good cause in implied contract cases, as well as the amount of managerial discretion afforded employers when faced with allegations of employee misconduct, remained unresolved.

**B. The California Supreme Court's Adoption of the Adequate Investigation Standard in *Cotran v. Rollins Hudig Hall International, Inc.***

The Supreme Court of California granted review in *Cotran* in order to "clarify the role of the jury in litigation alleging breach of an implied contract not to terminate employment except for good or just cause, and to resolve the conflict among the Courts of Appeal."<sup>56</sup>

**1. The Facts**

In *Cotran*, the plaintiff, Ralph Cotran, was a senior vice president of Rollins Hudig Hall International, Inc. ("Rollins"), an insurance brokerage firm.<sup>57</sup> After Cotran worked at Rollins for five years, two of his female subordinates accused him of sexual harassment, both saying that the "plaintiff had exposed himself . . . in their presence more than once . . . [and] ma[de] repeated obscene telephone calls to them at home."<sup>58</sup> Immediately after the complaints were made, the company president and human resources personnel met with Cotran, explained to him the allegations, and warned him that an investigation would ensue.<sup>59</sup> At the time of this initial meeting, Cotran "said nothing during the meeting about having had consensual relations with either of his two accusers, and offered no explanation for the complaints."<sup>60</sup>

Throughout the duration of the investigation of misconduct, Rollins suspended Cotran's employment.<sup>61</sup> The company interviewed twenty-one of Cotran's co-workers, including five people that Cotran requested be interviewed.<sup>62</sup> One of the women that Cotran requested be interviewed described him as a "perfect gentleman," but later

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55. See *Cotran v. Rollins Hudig Hall Int'l, Inc.*, 948 P.2d 412, 414 (Cal. 1998).

56. *Id.*

57. See *id.*

58. *Id.* at 415.

59. See *id.*

60. *Id.*

61. See *id.*

62. See *id.*



called to report “‘a strange early morning phone call’ from [Cotran] which ‘was not for any business purpose.’”<sup>63</sup> A woman who previously worked with Cotran at another company reported that Cotran made obscene phone calls to her after a sexual relationship between the two of them had ended.<sup>64</sup>

On the basis of the investigation, the company concluded that the women’s reports were credible, their stories were consistent, and that “it was more likely than not the harassment had occurred.”<sup>65</sup> Although Rollins had no absolute and undisputed evidence that Cotran engaged in misconduct, the company president decided to terminate Cotran’s employment based upon the investigative report and affidavits of the women interviewed.<sup>66</sup>

## 2. The Trial Court’s Decision

Cotran subsequently sued Rollins for wrongful termination, maintaining that he did not sexually harass the women.<sup>67</sup> Cotran claimed that he had an implied-in-fact contract for employment with Rollins requiring good cause for termination.<sup>68</sup> Cotran further argued that since he had not actually engaged in the alleged sexual harassment, there was no good cause for his termination.<sup>69</sup> At trial, Cotran, in contrast to his silence during the company’s investigation, testified that he had affairs and consensual sexual relations with both of his accusers. According to Cotran, he did not disclose these liaisons initially because he felt “frightened” and “ambushed” during the investigation.<sup>70</sup> Cotran further explained that he began seeing a third woman, whom he later married, while still dating one of his accusers, and that her accusations of sexual harassment were motivated by jealousy.<sup>71</sup> Cotran also claimed that one of the women was using the sexual harassment accusations to force Cotran to give her a substantial increase in salary.<sup>72</sup> Both women maintained their allegations of sex-

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63. *Id.*

64. *See id.*

65. *Id.* No one interviewed said it was impossible for Cotran to have engaged in the alleged activities. *See id.*

66. *See id.*

67. *See id.* at 415–16.

68. *See id.* at 414 & n.1.

69. *See id.* at 414–17.

70. *Id.* at 415–16.

71. *See id.*

72. *See id.* at 416.

ual harassment against Cotran, denying his contentions and testifying that they never had sex with him.<sup>73</sup>

After all the evidence was presented, the trial judge instructed the jury that in order to defeat Cotran's claim of wrongful termination, the company had to prove that he actually engaged in the alleged misconduct which led to his dismissal.<sup>74</sup> The jury found that the company failed to meet this burden and awarded Cotran \$1.8 million.<sup>75</sup> Rollins appealed,<sup>76</sup> and the Second District Court of Appeal reversed in his favor.<sup>77</sup> Cotran petitioned for review.<sup>78</sup>

### 3. The California Supreme Court's Decision

The California Supreme Court affirmed the appellate court's decision and held that the proper balance between an employer's interest in running its business efficiently and an employee's interest in maintaining his or her employment allows an employer to be wrong about whether misconduct actually occurred, as long as the termination decision was objectively reasonable and made in good faith.<sup>79</sup> In so ruling, the court expressly rejected the Second District Court of Appeal's holding in *Wilkerson*.<sup>80</sup> The court reaffirmed that employers are entitled to exercise substantial discretion in personnel decisions and should generally be free from the threat of a jury second-guessing their business judgment, particularly in handling high-ranking, managerial employees.<sup>81</sup> The court held that "[t]he proper inquiry for the jury . . . is [whether] the factual basis on which the employer concluded a dischargeable act had been committed [was] reached honestly, after an appropriate investigation and for reasons that that [sic] are not arbitrary or pretextual."<sup>82</sup>

The court stated that it would be "too intrusive" to have juries, who were removed from the "everyday reality of the workplace," reviewing the employer's factual conclusions months or years later.<sup>83</sup> Moreover, the court said, "[i]f an employer is required to have in

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73. *See id.*

74. *See id.*

75. *See id.*

76. *See id.*

77. *See id.*

78. *See id.*

79. *See id.* at 421-22.

80. *See id.* at 414.

81. *See id.* at 421.

82. *Id.* at 421-22.

83. *Id.* at 421.

hand a signed confession or an eyewitness account of the alleged misconduct before it can act, the workplace will be transformed into an adjudicatory arena and effective decision-making will be thwarted.”<sup>84</sup> The court found undesirable and contrary to public policy any such dampening of an employer’s willingness to act.<sup>85</sup>

At the same time, the *Cotran* court cautioned that employer discretion was not absolute and that an employer’s factual determination had to be a “reasoned conclusion . . . supported by substantial evidence gathered through an adequate investigation that includes notice of the claimed misconduct and a chance for the employee to respond.”<sup>86</sup> The court declined to describe more specifically the essential elements of an adequate investigation, instead leaving the matter to a subsequent case-by-case analysis.<sup>87</sup> The court also declined to specify what role, if any, the jury would have in deciding whether the employer’s proffered reasons for termination were legally sufficient to constitute good cause.<sup>88</sup>

## II. Analysis of *Cotran*’s Adequate Investigation Standard

### A. The Effects of *Cotran* on California Employers

Since the California Supreme Court decided the *Cotran* case on January 5, 1998, it has had a great impact upon employers in California. While the supreme court’s intent was to reduce the risk to an employer taking remedial action to enforce laws against sexual harassment and other improper workplace conduct, *Cotran* raised several issues that must be dealt with in further litigation over the next several years.<sup>89</sup>

The *Cotran* court de-emphasized whether the misconduct actually occurred and turned “[t]he litigation laser . . . on the quality of the investigation” of the misconduct.<sup>90</sup> However, an inherent, and arguably inescapable, flaw in the court’s decision lies in the fact that it entirely fails to define what constitutes an adequate investigation.

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84. *Id.*

85. *See id.* at 420.

86. *Id.* at 422.

87. *See id.*

88. *See id.* at 423.

89. *See* Lynn A. Bersch & Paul D. Fogel, *Pandora’s Workplace: Though Cotran Resolves a Vital Wrongful Discharge Question, It Raises Other Issues that Will Keep Lower Courts Busy for Years*, THE RECORDER, Feb. 4, 1998, at 5.

90. Jacobus, *supra* note 1, at 7.

Employers are under a great deal of pressure to take action against allegations of sexual harassment and other forms of employee misconduct in order to escape liability. The *Cotran* decision has served to encourage claims by discharged employees based on the inadequacy of their employers' investigation of alleged misconduct.<sup>91</sup> As a result, California employers are presently feeling increased pressure from two directions: from the employee who makes the allegations (the victim) and from the employee against whom the allegations are made (the accused).<sup>92</sup>

The judicial system has been flooded with an increased number of employment claims. The United States Equal Employment Opportunity Commission ("EEOC") has reported that a significantly increased number of false sexual harassment claims are presently being filed.<sup>93</sup> In 1999, immediately following *Cotran*, the EEOC rejected 7,243 sexual harassment claims for "no reasonable cause, meaning that investigators were unable to substantiate the allegations."<sup>94</sup>

As a result, even more discharged employees are filing "fight back" lawsuits.<sup>95</sup> These suits seldom survive summary judgment.<sup>96</sup> While the *Cotran* decision has considerably reduced an employer's burden to sustain a termination decision in misconduct cases, it has, at the same time, burdened the court system with an increased number of lawsuits brought against employers by terminated employees based upon claims that their employers failed to investigate adequately.<sup>97</sup>

Neither the California legislature nor the California Supreme Court, in a subsequent decision, is fully able to clarify what constitutes an adequate investigation of allegations of employee misconduct. Each case is very fact specific and requires a unique form of investigation. The relatively ambiguous application of the adequate investigation standard to all types of employee misconduct to find good cause for termination is left to be deciphered through future litigation. For now, however, California courts have decided two subsequent cases

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91. See Ralph H. Baxter, Jr. & Thomas P. Klein, *California High Court Rules that Employers Can Fire Employees for Misconduct Based on Good-Faith Belief Resulting from Investigation, Without Actual Proof*, NAT'L L.J., Feb. 16, 1998, at B5.

92. See Jacobus, *supra* note 1, at 6.

93. See *id.* at 1.

94. *Id.*

95. See *id.*

96. See *id.*

97. See generally *id.* at 1, 7.

which help further define an adequate investigation introduced in *Cotran*.

## **B. Subsequent Case Law Further Defines an Adequate Investigation**

In *Silva v. Lucky Stores, Inc.*,<sup>98</sup> Lucky Supermarket ("Lucky") discharged Silva, a store manager who had worked there for twenty-eight years, following a month-long investigation of allegations made by two female employees that Silva had sexually harassed them.<sup>99</sup> Silva denied the allegations and "sued Lucky Supermarket for breach of an implied contract not to terminate except for good cause and for breach of the implied covenant of good faith and fair dealing."<sup>100</sup> The trial court found no triable issues of fact and decided in favor of Lucky.<sup>101</sup> Silva appealed.<sup>102</sup> The Fifth District Court of Appeal affirmed, finding that the investigation by the employer's human resources personnel was adequate to sustain the discharge of his employment.<sup>103</sup>

The court began its analysis by restating the *Cotran* standard for good cause in termination cases.<sup>104</sup> First, the employer must have acted in good faith in making the decision to terminate.<sup>105</sup> Second, the decision must have followed an investigation that was appropriate under the circumstances.<sup>106</sup> Finally, the employer must have had reasonable grounds for believing that the employee had engaged in the misconduct.<sup>107</sup>

Lucky Supermarket had an effective written policy in effect regarding how to investigate complaints of harassment.<sup>108</sup> The investigation in *Silva* was conducted by a specifically designated independent human resource representative, who conducted interviews confidentially on the store premises or on the telephone.<sup>109</sup> The investigator asked "relevant, open-ended, and non-leading questions" in an at-

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98. 76 Cal. Rptr. 2d 382 (Ct. App. 1998).

99. *See id.* at 384.

100. *Id.*

101. *See id.*

102. *See id.*

103. *See id.* at 390-92, 395.

104. *See id.* at 387.

105. *See id.*

106. *See id.*

107. *See id.*

108. *See id.*

109. *See id.* at 388-94.

tempt to elicit facts and "not opinions or suppositions."<sup>110</sup> The investigation included interviews with any employees who may have witnessed the alleged conduct.<sup>111</sup> Interviews with the female employees who made the accusations were also conducted, giving them the opportunity to clarify, correct, or challenge information provided by the other witnesses.<sup>112</sup> The company then conducted an interview with Silva to allow him to present his version of the facts and give him a final opportunity to comment on all of the information gathered during the investigation.<sup>113</sup> Although the court did find some flaws in the investigation, it held that Lucky's decision to terminate Silva's employment was reasonable and supported by substantial evidence.<sup>114</sup>

In a subsequent case, *Cozza v. Northrup Grumman Corp.*,<sup>115</sup> Cozza sued his former employer for age discrimination and breach of an implied contract not to terminate except for good cause.<sup>116</sup> Cozza's former employer, Northrup Grumman Corp. ("Northrup"), maintained that Cozza had falsified documents and committed gross negligence while handling business matters, which it claimed constituted good cause for his dismissal.<sup>117</sup> Northrup conducted an investigation of the alleged misconduct.<sup>118</sup> The investigation included a thorough interview with Cozza; interviews with several other employees involved in the misconduct engaged in by Cozza, who were also reprimanded; review of a report by the company's Employee Relations Department; and an opportunity for Cozza to present his case before a neutral committee of three senior managers.<sup>119</sup> The district court granted the employer's motion for summary judgment, finding that the company had conducted an adequate investigation and had discharged Cozza in good faith.<sup>120</sup>

The adequate investigation standard for establishing good cause for termination is in its infancy and has not yet had the time to evolve into a truly useful doctrine of law.<sup>121</sup> Under *Cotran*, lower courts are forced to contend with an entirely new issue in litigation of termina-

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110. *Id.* at 392.

111. *See id.* at 388-91.

112. *See id.*

113. *See id.* at 391-92.

114. *See id.* at 394, 395.

115. 41 F. Supp. 2d 1089 (C.D. Cal. 1999).

116. *See id.* at 1090.

117. *See id.* at 1091.

118. *See id.*

119. *See id.* at 1095-96.

120. *See id.* at 1095.

121. *See Jacobus, supra* note 1, at 7.

tion cases: Did the employer conduct an adequate investigation of the alleged workplace misconduct? Employers are currently caught in the middle of an ambiguous situation, which must inevitably be sorted out over the next few years in further litigation of the adequate investigation standard.<sup>122</sup> Despite these valid concerns, however, *Cotran* undoubtedly was a useful step towards relieving some of the burdens employers face when defending their decisions to terminate an employee accused of misconduct.

### III. The Fair Credit Reporting Act and the Vail Letter

The current and more immediately resolvable problem faced by California employers involves the Vail Letter,<sup>123</sup> which interprets the language of recent amendments to the FCRA.<sup>124</sup> The Vail Letter states that the FCRA applies to investigations of employee misconduct conducted by third party investigators or attorneys hired by the employer.<sup>125</sup> The effect of applying the FCRA in such a way has significant implications on the effectiveness of investigations of employee misconduct across the nation, particularly in California in light of *Cotran*.

#### A. The Regulations Imposed by the FCRA and Its Congressional Purpose

The FCRA is a federal law that requires an employer to notify employees and job applicants, and get their consent, before running a credit or background check on them.<sup>126</sup> Additional disclosures are required if an employer uses the information discovered "as the basis for an adverse employment action against the employee or applicant."<sup>127</sup>

The FCRA was enacted to protect consumers against the misuse of, and inaccuracies in, consumer reports used to determine eligibility for credit, insurance, and employment purposes. Specifically, the intent of the FCRA was to assure, by means of fair and accurate

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122. See Baxter & Klein, *supra* note 91, at B5.

123. See Vail Letter, *supra* note 14; see also sources cited and discussion *supra* note 13.

124. See Vail Letter, *supra* note 14 (interpreting portions of 15 U.S.C. §§ 1681, 1681a-1681u (1994 & Supp. IV 1999)).

125. See *id.*

126. See Perkins Coie, *FTC Throws a Wrench into Sexual Harassment and Other Workplace Investigations*, 4 No. 9 ALA. EMP. L. LETTER 2 (Sept. 1999).

127. *Id.*

credit reports, "public confidence . . . essential to the continued functioning of the banking system."<sup>128</sup>

"Supporters of the FCRA recognized that when inaccurate or arbitrary information bearing on a consumer's credit trustworthiness was circulated to lending institutions or used as a factor in employment, such information could unjustly damage the consumer."<sup>129</sup> After Congress enacted the FCRA, the FTC had the ability to "require consumer reporting agencies to maintain records, prevent the unreasonable or careless invasion of consumer privacy, and encourage consumer reporting agencies to use fair and impartial procedures."<sup>130</sup>

## B. The 1996 Amendments to the FCRA

In 1996, Congress amended the FCRA.<sup>131</sup> As a result of the amendments, employers are faced with even further restrictions on their use of consumer reports from outside consumer reporting agencies.<sup>132</sup> A "consumer reporting agency" is defined as "any person which, for monetary fees . . . regularly engages in whole or in part in the practice of assembling or evaluating . . . information on consumers for the purpose of furnishing consumer reports to third parties."<sup>133</sup> A "consumer report" is defined as any "communication of any information . . . bearing on a consumer's credit worthiness, credit standing, credit capacity [or] character . . . which is used or expected to be used or collected in whole or in part for . . . employment purposes."<sup>134</sup>

The 1996 amendments obligate an employer to "disclose in writing its intention to acquire a consumer report and to receive written authorization from the employee before initiating the inquiry."<sup>135</sup> The employer must also provide the accused employee a full, unedited copy of the investigative report upon its completion, but before taking adverse employment action against the accused based on the report.<sup>136</sup> The FCRA also requires employers to give the accused em-

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128. David B. Fein & Suzanne E. Wachsstock, *Compromising Compliance: FTC Opinion Undercuts Corporations' Ability to Unearth Workplace Problems*, LEGAL TIMES, Sept. 20, 1999, at S34 (quoting 15 U.S.C. § 1681(a)(1) (1994)) (citations omitted) (alteration in original).

129. *Id.*

130. *Id.* at S35.

131. See 15 U.S.C. § 1681 (Supp. IV 1999) (enacting changes to FCRA effective 1997).

132. See *id.*

133. 15 U.S.C. § 1681a(f) (1994).

134. *Id.* § 1681a(d)(1)(C).

135. Fein & Wachsstock, *supra* note 128, at S34. See also 15 U.S.C. § 1681b(b)(2)(A) (Supp. IV 1999).

136. See 15 U.S.C. § 1681b(b)(3)(A).



ployee a description of the rights required by the FCRA in writing before taking adverse employment action, such as termination or reprimand.<sup>137</sup> If an employer negligently fails to comply with the FCRA, an accused employee can bring an action for actual damages as well as attorney's fees.<sup>138</sup> If an employer willfully fails to comply with the FCRA's strict notice, consent, and disclosure requirements, an employee can also bring an action for punitive damages.<sup>139</sup> Thus, the FCRA provides employees who are the subject of workplace investigations another cause of action to bring against their employers in court.

### C. The Vail Letter

Neither the FCRA nor its amendments expressly regulate the employment relationship in any respect unrelated to credit.<sup>140</sup> "The act on its face has no application to internal employer investigations limited to misconduct in the workplace."<sup>141</sup> However, on April 5, 1999, FTC staff attorney Christopher Keller wrote an opinion letter in response to an inquiry by Judy A. Vail, stating that the FCRA applies to internal investigations of employee misconduct.<sup>142</sup> The Vail Letter specifically "concluded that 'outside organizations utilized by employers to assist in their investigations of harassment claims' may be consumer reporting agencies . . . and, if so, the reports they issue would constitute investigative consumer reports subject to the FCRA."<sup>143</sup>

The FTC interprets the FCRA to extend to harassment investigations conducted by outside agencies for three reasons. First, an outside agency "assembles or evaluates" information upon the employer's request and is, therefore, a "consumer reporting agency."<sup>144</sup> Second, the report prepared by the agency of the investigation is a "consumer report" because it contains information reflecting upon the employee's reputation and character.<sup>145</sup> Finally, the consumer reporting agency collects the information knowing that the employer will use the report for employment purposes, namely to decide

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137. *See id.*

138. *See* 15 U.S.C. § 1681o(a)(1)-(2) (Supp. IV 1999).

139. *See* 15 U.S.C. § 1681n(a) (Supp. IV 1999).

140. *See* Fein & Wachsstock, *supra* note 128, at S34.

141. *Id.* at S35.

142. *See* Kandel, *supra* note 23, at 156-57 (quoting Vail Letter, *supra* note 14).

143. *Id.* at 157.

144. *See* Vail Letter, *supra* note 14.

145. *See id.*

whether to retain an employee.<sup>146</sup> As discussed below, this decision has raised significant concerns for employers across the nation, especially those in California.

#### IV. The Effects of the FCRA and the Vail Letter on Investigations of Employee Misconduct Undertaken in Light of *Cotran*

After the *Cotran* decision, multitudes of lawsuits arose challenging the adequacy of employers' investigations of employee misconduct.<sup>147</sup> As demonstrated in *Silva* and *Cozza*, employer investigations in California have been placed under scrutiny, and their thoroughness and efficiency are of the utmost importance.

The adequacy of workplace investigations of misconduct is also a concern of employers across the nation. In *Faragher v. City of Boca Raton*,<sup>148</sup> the United States Supreme Court held that an employer can be held vicariously liable for a supervisor's sexual harassment of a subordinate.<sup>149</sup> The Court, however, "balanced the employer's high risk of liability under such a theory by establishing a potential affirmative defense."<sup>150</sup> An employer can shield itself from vicarious liability if (1) the employer exercised reasonable care to prevent and correct the harassment, and (2) the employee unreasonably failed to take advantage of any preventive or corrective procedures provided by the employer.<sup>151</sup>

Thus, under both California and federal case law, the objective nature and adequacy of investigations of employee misconduct are crucial to avoid liability. As a result, employers should use outside parties to conduct these investigations, rather than in-house counsel and human resource personnel, in order to guarantee the highest degree of trustworthiness and to avoid bias.<sup>152</sup>

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146. See *id.*

147. See Jacobus, *supra* note 1, at 7.

148. 524 U.S. 775 (1998).

149. See *id.* at 780.

150. 1999 LABOR & EMPLOYMENT LAW SYMPOSIUM, *supra* note 26, at 2.

151. See *Faragher*, 524 U.S. at 807.

152. See Mason, *supra* note 12, at S32.

## A. California Employers Need Third Party Investigators to Conduct an Adequate Investigation of Workplace Misconduct

### 1. Problems with Using Human Resources Personnel

Traditionally, human resource personnel and in-house counsel, both internal parties not subject to the regulations of the FCRA, have been utilized to conduct investigations of employee misconduct.<sup>153</sup> However, in light of the increased emphasis on the objectiveness of such investigations in California since *Cotran*, it is no longer wise for employers to allow these employees to conduct the investigations.

Human resource personnel can conduct such investigations in some straightforward cases, such as in *Silva*, where "the issues [are] relatively simple and key facts [are] not in dispute."<sup>154</sup> However, unlike *Silva*, "many sexual harassment claims, especially hostile work environment claims in which no allegations of physical contact are made, are far more problematic. Context and atmosphere come into play, and decisions by employers as to remedial action become more perilous."<sup>155</sup>

In order for an employer to succeed in an action challenging the adequacy of an investigation of workplace misconduct, it is of the utmost importance that the investigation be viewed as objective.<sup>156</sup> "[H]uman resources employees may be incapable of objectivity due to inextricable links to the political fabric of the office. Office alliances and enmities can be very difficult to overcome for an employee-investigator steeped in them or buffeted by them."<sup>157</sup> The accuser and the accused may rightfully be afraid that their statements will not be accurately recorded or their claims may not thoroughly be considered if a company employee, too involved in the action or personally close to a party, conducts the inquiry.<sup>158</sup> If the fitness, ability, experience, or legal knowledgeability of human resources to investigate a claim comes under scrutiny, the employer's exposure to litigation can significantly increase.<sup>159</sup>

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153. See Nancy L. Abell, *Conducting an Effective Workplace Investigation*, VLR 994 A.L.I.-A.B.A. 459, 469 (Sept. 14, 1999), available in WESTLAW at VLR 994 ALI-ABA 459.

154. Mason, *supra* note 12, at S33.

155. *Id.*

156. See *id.*

157. *Id.*

158. See *id.* at S32.

159. See *id.*

It is incumbent upon the employer to conduct the investigation in a manner that allows for the relative comfort of the witnesses, eliminating the threat of intimidation or fear of retaliation. Employees often voice concerns that human resources departments are an extension of the authority structure of the employer, and, by definition, incapable of neutrality.<sup>160</sup>

It is understandable for employees to fear that investigations of these sensitive issues might be biased if done by one close to the management and other fellow employees.<sup>161</sup>

"Moreover, if the employer's harassment policy itself is at issue, it is awkward at best to ask a [Human Resources] employee to investigate the nature and efficacy of the policy the [Human Resources] department itself implements."<sup>162</sup> As discussed above, in *Faragher*, the United States Supreme Court ruled "in essence that an employer can assert as a defense to vicarious liability the reasonableness of its sexual harassment policy and the reasonableness (or lack) of the employee's conduct in seeking to avoid harm."<sup>163</sup> In order to make use of this crucial defense, an employer is wise to hire a third party, experienced and well-versed in employment law, to determine whether a policy is reasonable or whether the alleged misconduct is included within the prohibited conduct set forth in the policy.<sup>164</sup>

## 2. Problems with Using In-House Counsel

Problems similarly arise when an employer has its in-house counsel conduct the investigation of employee misconduct.<sup>165</sup> Issues present themselves in the areas of trustworthiness and bias. Attorneys who insert themselves into the investigative phase of a case run the risk of becoming fact witnesses because, especially after *Cotran*, the investigation is directly at issue in the litigation.<sup>166</sup> "The attorney may find it rather awkward to confront a witness with a contradictory statement if counsel himself was the person to whom that statement was made."<sup>167</sup> Thus, the attorney many times has no choice but to either withdraw as counsel or forego the opportunity to undermine the witness's credibility on cross examination.<sup>168</sup>

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160. *Id.*

161. *See id.*

162. *Id.*

163. *Id.* at S33.

164. *See id.*

165. *See id.*

166. *See id.*

167. *Id.*

168. *See id.*

Furthermore, fruits of an employee misconduct investigation conducted by an attorney are not privileged in litigation stemming from the misconduct.<sup>169</sup> If litigation of employment misconduct ensues, the employer must prove that the attorney conducted a proper investigation, analyzed the facts learned, and took appropriate action to prevent the recurrence of the alleged misconduct.<sup>170</sup>

If a defendant employer hopes to prevail by showing that it investigated an employee's complaint and took remedial action appropriate to the findings of the investigation, then it will have put the adequacy of the investigation directly at issue, and cannot stand on the attorney-client privilege or work product doctrine to preclude a thorough examination of its adequacy.<sup>171</sup>

Therefore, if an employer chooses to have its attorney conduct the investigation, the attorney-client privilege and the work product doctrine are thereby waived.<sup>172</sup>

Attorneys clearly cannot both investigate employee misconduct claims and shield the results of the investigation from discovery in cases where the investigation is the focus of the litigation.<sup>173</sup> Consequently, counsel for employers should stay out of the investigation to avoid becoming a fact witness and to avoid limiting an employer's options in defending its actions.

Furthermore, small businesses many times "do not have the in-house capacity to conduct thorough and credible investigations."<sup>174</sup> As a result, small businesses frequently have no choice but to rely on outside entities to conduct their investigations of workplace misconduct.<sup>175</sup> Therefore, it is crucial in many instances for employers, both large and small, to hire third party investigators to both avoid liability and to have a sufficient opportunity to defend the adequacy of their workplace investigations.<sup>176</sup>

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169. See *id.* at S32.

170. See Abell, *supra* note 153, at 469.

171. Wellpoint Health Networks, Inc. v. Superior Court, 68 Cal. Rptr. 2d 844, 856 (Ct. App. 1997).

172. See *id.*; see also Mason, *supra* note 12, at S33.

173. See generally Jenna Ward, *For This Mystery, You May Want an Attorney*, THE RECORDER, Apr. 20, 1998, at 4.

174. Fair Credit Reporting Amendments Act of 1999: Hearing on H.R. 3408 Before the Subcomm. on Financial Institutions and Consumer Credit of the House Comm. on Banking and Financial Services, 106th Cong. (2000) [hereinafter *FCRA Hearing*] (statement of Ida L. Castro, Chairwoman of the Equal Employment Opportunity Commission), available at 2000 WL 19303231.

175. See *id.*

176. See *id.*

## **B. The Regulations Imposed by the FCRA Significantly Decrease the Effectiveness of Investigations Conducted by Third Parties**

Having recognized the need for outside investigators, employers are faced with the dilemma resulting from the FTC's position described in the Vail Letter that the FCRA is applicable to employer investigations of employee misconduct conducted by a third party.<sup>177</sup> The amendments to the FCRA require that employers who procure "consumer reports" for employment purposes provide both a clear and conspicuous disclosure in writing to the employee before the report is obtained or the investigation launched.<sup>178</sup> Employers must further obtain the employee's consent to conduct the investigation.<sup>179</sup> The employer is also required to provide the employee alleged to have engaged in misconduct with an unedited copy of the completed investigative report and a description in writing of the employee's rights under the FCRA.<sup>180</sup>

"Requiring a suspect employee's consent prior to an investigation and the full disclosure of investigative information to that employee would all but eliminate a company's ability to receive information from employees and to act effectively on that information."<sup>181</sup> Many employees alleged to have engaged in prohibited workplace conduct would simply not consent, "thus ending the employer's ability to obtain outside assistance in undertaking an investigation right from the start."<sup>182</sup> At the very least, by "strategically withholding consent, the employee can delay an investigation or otherwise control its timing."<sup>183</sup> This advance notice can provide the alleged wrongdoer the ability to prepare his or her responses to avoid responsibility, influence testimony of potential witnesses, or even destroy evidence.<sup>184</sup>

Those employees who do consent are required to receive a full investigative report by their employer, including all memos of interviews with co-workers.<sup>185</sup> Thus, the Vail Letter will only serve to sub-

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177. See Vail Letter, *supra* note 14.

178. See *supra* notes 135-39 and accompanying text.

179. See Kandel, *supra* note 23, at 158.

180. See *id.*

181. Fein & Wachsstock, *supra* note 128, at S34.

182. *Id.*

183. FCRA Hearing, *supra* note 174 (statement of Ida L. Castro, Chairwoman of the Equal Employment Opportunity Commission).

184. See *id.*

185. See *id.*

stantially limit future employee cooperation.<sup>186</sup> When deprived of confidentiality protections, many witnesses will not come forward.<sup>187</sup> It could also breed hostility and retaliation within the company and between employees. Furthermore, the effect of the FTC's opinion "poses a real risk of harm to employees and others in the workplace where the individual to be investigated appears to present a risk of workplace violence."<sup>188</sup> While persons accused of harassment or other forms of workplace discrimination should certainly have sufficient information in order to respond to charges and defend themselves, they do not need the names of all witnesses or a full, unedited copy of the investigative report.<sup>189</sup>

The FCRA supplies an "important protection to prospective employees against the use of inaccurate, obsolete, or disputed [credit] information that bears upon the employment decision."<sup>190</sup> However, the restraints of the FCRA as applied to investigations of employee misconduct are inconsistent with the letter and spirit of the FCRA and place employers in an untenable position.<sup>191</sup> They must either conduct internal investigations without outside help or obtain the consent of suspected employees before investigating, and then disclose all results of the investigation to those employees. "It puts the employer in the bizarre position of receiving a complaint and then having to get the consent of the accused harasser to do an investigation."<sup>192</sup> The drafters of the FCRA could not have envisioned this outcome.<sup>193</sup>

In California, the consequences of the FTC opinion expressed in the Vail Letter are heightened due to *Cotran*. The adequacy of misconduct investigations are pivotal in the litigation of claims brought by terminated employees. Employers are now faced not only with an increased number of claims challenging the adequacy of their investigations, but also with the severe restrictions of the FCRA which serve to hinder the overall efficiency of the investigations that employers undertake.

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186. *See id.*

187. *See id.*

188. Teresa L. Butler, *Credit Reporting Act Imperils Workplace Probes; Amendments Needed to Allow for Confidential Investigations of Misconduct*, FULTON DAILY REP., Aug. 5, 1999, at 12.

189. *See FCRA Hearing*, *supra* note 174 (statement of Ida L. Castro, Chairwoman of the Equal Employment Opportunity Commission).

190. Fried, *supra* note 17, at 229.

191. *See* Fein & Wachstock, *supra* note 128, at S34.

192. Kevin Livingston, *FTC Drops Employment Law Bomb: New Opinion Says Harassment Investigations by Lawyers Are Illegal*, THE RECORDER, May 17, 1999, at 3.

193. *See* Fried, *supra* note 17, at 230-32.

## V. Applying the Restrictive Requirements of the FCRA to Investigations of Workplace Misconduct Is Contrary to the Language of the FCRA and Fails to Further the Purpose of the FCRA

The FTC has stated that its expansive interpretation of “investigative consumer report” and “consumer reporting agency” is merited because of important privacy and procedural rights the FCRA provides to employees when an employer retains an outside agency to conduct a workplace investigation.<sup>194</sup> Although under an extremely broad reading of the FCRA, “the FTC position may be supported by the plain meaning of the Act, it is not logical in practice.”<sup>195</sup> Not only does the application of the FCRA’s stringent consent and disclosure requirements hinder the overall efficiency of an employer’s investigation of employee misconduct, but it also fails to serve the purposes of the FCRA. First, an employer who utilizes a third party to conduct employee investigations does so for a legal purpose, and not an employment purpose, and thus the investigative report is not a consumer report under the FCRA.<sup>196</sup> Second, applying FCRA in such a way does not serve the stated congressional purpose of the Act.<sup>197</sup> Finally, “the employment agreement between the employer and employee should supercede the obligations of the FCRA, just as an insurance contract between the insured and the insurer supercedes FCRA requirements.”<sup>198</sup>

### A. Employers Conduct Investigations of Employee Misconduct for Legal, Not Employment, Purposes

The FCRA only applies when an investigative report is used for “employment purposes.”<sup>199</sup> An investigative report is used for employment purposes if it is used to make an “adverse employment decision” such as for corrective or disciplinary action.<sup>200</sup> If a report is not used for this purpose, the FCRA does not apply.<sup>201</sup>

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194. See *FCRA Hearing*, *supra* note 174 (statement of Debra Valentine, General Counsel, Federal Trade Commission), available at <http://www.house.gov/banking/5400val.htm>.

195. Fried, *supra* note 17, at 228.

196. See *id.*

197. See *id.* at 228–29.

198. *Id.* at 229.

199. See *id.*

200. See Vail Letter, *supra* note 14.

201. See Fried, *supra* note 17, at 229.



One court has recently declined to consider an investigative report of employee misconduct a "consumer report" as defined by the FCRA because the purpose behind the investigation was to provide legal advice to the employer in anticipation of litigation.<sup>202</sup> In *Robinson v. Time Warner, Inc.*,<sup>203</sup> Robinson, an employee, brought a discrimination action against his employer, Time Warner, Inc., and sought discovery of an investigative report prepared by Time Warner's outside counsel to investigate Robinson's allegations.<sup>204</sup> Robinson relied in part upon the FCRA and the Vail Letter as grounds for disclosure of the law firm's report.<sup>205</sup> The Southern District of New York held that the questions posed and the answers received by Time Warner's outside counsel during the investigation of discrimination were rendered in anticipation of litigation.<sup>206</sup> Thus, the court found the report "was prepared in order to provide legal advice to the company, and not for the purpose of evaluating Robinson and taking 'adverse action' against him."<sup>207</sup> The report was protected by the attorney-client privilege and the work product doctrine and did not fall within the ambit of the FCRA.<sup>208</sup>

This reasoning also applies in the context of the California Supreme Court's decision in *Cotran* and the United States Supreme Court's decision in *Faragher*. With the current emphasis on the adequacy of employer investigations of employee misconduct both in state actions against employers and in the formulation of the affirmative defense to vicarious liability in federal actions, "employers have greater incentive to conduct a full, adequate, and independent investigation of sexual harassment complaints in order to strengthen their defense in the event of a lawsuit."<sup>209</sup> An employer retains an outside investigative agency, particularly outside counsel experienced in employment law, to provide legal advice to the employer when faced with allegations of employee misconduct in order to avoid possible liability.<sup>210</sup> As the *Robinson* court stated, these investigations are conducted for a legal purpose.<sup>211</sup> The incentive for an employer to strengthen its

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202. See *Robinson v. Time Warner, Inc.*, 187 F.R.D. 144, 147-48 (S.D.N.Y. 1999).

203. 187 F.R.D. 144 (S.D.N.Y. 1999).

204. See *id.* at 145-46.

205. See *id.* at 147-48.

206. See *id.* at 148 n.2.

207. *Id.*

208. See *id.* at 146.

209. Fried, *supra* note 17, at 229-30.

210. See *id.* at 229.

211. See *Robinson*, 187 F.R.D. at 146.

defense is diminished if such investigations continue to be classified as having an "employment purpose," and thereby hindered by the FCRA's requirements of consent and disclosure.<sup>212</sup> Thus, both Congress and state courts should construe investigations of employee misconduct prepared by outside agencies as legal documents not subject to FCRA's requirements.

#### **B. The FCRA Requirements of Consent and Disclosure Do Not Further the Purpose of the Act**

Congress enacted the FCRA to protect consumers' reputations and credit-worthiness and the banking system from the effects of unfair credit reporting methods.<sup>213</sup> The FCRA protects individuals from being denied employment, insurance, and credit on the basis of inaccurate or obsolete credit reports.<sup>214</sup> However, "[t]he FCRA is neither a proper nor an efficient way to protect an employee accused of harassment from the reporting of, or an employer's reliance upon, such information."<sup>215</sup>

One accused of workplace misconduct cannot examine and correct errors in an investigative report in the same way that he or she could review a credit report.<sup>216</sup> The subjective nature of observations made by witnesses during interviews makes it impossible for the accused to definitively prove information included in the report wrong or inaccurate.<sup>217</sup> The employer is simply "not in a position to check the accuracy of the opinions and observations of the complainant-employee or other witnesses interviewed by the outside agency."<sup>218</sup> Subjecting investigative reports prepared by outside agencies subject to the FCRA's provisions, including getting the accused's consent and providing him or her with an unedited copy of the report, will not increase the accuracy or truth of the information included in the report.<sup>219</sup>

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212. See Fried, *supra* note 17, at 230.

213. See 15 U.S.C. § 1681(a) (1994).

214. See Fried, *supra* note 17, at 220.

215. *Id.* at 230.

216. See *id.*

217. See *id.*

218. *Id.* at 231.

219. See *id.*

### C. The Employment Agreement, Not the FCRA, Should Protect a Current Employee

The FCRA supplies significant protections to a prospective employee against inaccurate and obsolete information that an employer may use when making an employment decision.<sup>220</sup> The protections of FCRA, however, should not continue to apply after the employer hires the job applicant, thereby establishing an employer-employee relationship.<sup>221</sup> The FCRA is inapplicable to insurance company investigations of claims,<sup>222</sup> "indicating that perhaps Congress did not intend the FCRA to apply after the establishment of a relationship between the subject of a report and the person requesting the report."<sup>223</sup> The definition of "consumer report" under the FCRA includes any report used "for the purpose of serving as a factor in establishing the consumer's eligibility for . . . insurance."<sup>224</sup> FCRA requirements, however, "do not apply after the development of a contractual relationship between the insurance company and the individual, specifically, when reports are prepared in response to an insured's claim on a policy."<sup>225</sup>

The differentiation between an insurer's initial insurance decision and investigations of insurance claims should also apply in the employment context.<sup>226</sup> The FCRA should protect only prospective employees from the employer's use of inaccurate credit-related information when deciding whether to employ an applicant.<sup>227</sup> Once an employer hires the individual, the FCRA should cease to apply.<sup>228</sup> "Rather, the terms of the employment contract . . . [should] provide the employee with adequate protection from arbitrary and unfair employment decisions made with respect to promotion, reassignment, and retention."<sup>229</sup>

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220. *See id.* at 232.

221. *See id.*

222. *See Hovater v. Equifax, Inc.*, 823 F.2d 413, 419–20 (11th Cir. 1987) (holding that after a consumer purchases an insurance policy, the FCRA's requirements no longer apply to investigations of insurance claims).

223. Fried, *supra* note 17, at 232–33.

224. 15 U.S.C. § 1681a(d)(1) (1994).

225. Fried, *supra* note 17, at 233.

226. *See id.* at 234.

227. *See id.*

228. *See id.*

229. *Id.*

## VI. Proposed Solutions to the Conflict Between the FCRA and the Efficiency of Investigations of Workplace Misconduct

Both the FTC and Congress recognized the difficulties faced by an employer who both attempts to comply with the FCRA and uses outside agencies to investigate workplace misconduct.<sup>230</sup> The FTC has suggested several ways employers can avoid FCRA requirements, and two statutory amendments have been proposed in the House of Representatives to alleviate the dilemma. House Bill 4373<sup>231</sup> is an amendment suggested by the FTC that would provide employees some of the FCRA consumer protections, yet allow an employer to retain an outside agency to conduct workplace investigations.<sup>232</sup> The amendment proposed in House Bill 3408<sup>233</sup> excludes investigations by outside agencies entirely from FCRA requirements.<sup>234</sup> These solutions, as currently proposed, fail to satisfactorily resolve the conflict between the FCRA and the efficiency of investigations of workplace misconduct.<sup>235</sup>

### A. The Medine Letter

The FTC, aware of the problems caused by applying FCRA requirements to investigations of workplace misconduct, has proposed several solutions. David Medine, the FTC's Associate Director of the Division of Financial Practices, stated in an opinion letter ("Medine Letter") that the FTC appreciates and is "sympathetic to the practical problems that exist in applying the FCRA to investigations by third parties of workplace misconduct."<sup>236</sup> He proposed two solutions he believed would allow employers to comply with the FCRA, while at the same time disposing of the stringent consent and disclosure requirements.<sup>237</sup>

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230. *See id.*

231. H.R. 4373, 106th Cong. (2d Sess. 2000).

232. *See id.*

233. Fair Credit Reporting Amendments Act of 1999, H.R. 3408, 106th Cong. (1st Sess. 1999).

234. *See id.*

235. *See* Fried, *supra* note 17, at 235.

236. Letter from David Medine, Assoc. Dir., Division of Financial Practices, Federal Trade Commission, to Susan R. Meisinger, Society for Human Resource Management (Aug. 31, 1999), <http://www.ftc.gov/os/statutes/fcra/meisinger.htm> [hereinafter Medine Letter].

237. *See id.*

In the Medine Letter, the FTC proposed first that an employer may obtain employees' consent to procure an investigative report by "routinely [obtaining consent] at the start of employment, thereby relieving the employer of the awkward prospect of having to ask a suspected wrongdoer for permission to allow a third party to provide an investigative (or other) consumer report to the employer."<sup>238</sup>

This proposal is not adequate.<sup>239</sup> If Congress truly intended for the FCRA requirements and protections to apply to investigations of workplace misconduct, this proposal fails to serve its aims by ironically allowing employers to force employees to waive their rights under FCRA prior to the commencement of their employment.<sup>240</sup> The FTC has stated that despite the conflict between the FCRA requirements and the efficiency of workplace investigations, it is important that employees retain the protections of the FCRA.<sup>241</sup> However, this FTC proposal allows employers to dispose of the consent requirement before an investigation is even necessary. Moreover, "routine notice and consent would not satisfy the FCRA statutory requirements when a [consumer reporting agency] prepares an investigative consumer report containing interviews."<sup>242</sup> The FCRA requires additional notice and disclosure when an investigative consumer report is procured, which the Medine Letter fails to address.<sup>243</sup>

The second proposed solution by the FTC in the Medine Letter is equally inadequate.<sup>244</sup> In the letter, the FTC suggests that in order to alleviate workplace tensions when disclosing the entire report to the accused, an employer can request that "an investigative agency . . . draft its report to the employer . . . by not naming parties that provide negative information regarding the employee."<sup>245</sup> This solution will not aid an employer attempting to conduct a thorough and adequate investigation to avoid liability under *Cotran*. Nor will it help the em-

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238. *Id.*

239. *See* Fried, *supra* note 17, at 236.

240. *See id.*

241. *See* Letter from Robert Pitofsky, Chairman, Federal Trade Commission, to Representative Pete Sessions, United States House of Representatives (Mar. 31, 2000).

242. Fried, *supra* note 17, at 236.

243. *See id.* The FCRA requires that notice of a pending investigation be mailed or otherwise delivered within three days after the date on which the report was requested. *See* 15 U.S.C. § 1681d(a)(1)(A) (Supp. IV 1999). The employer must also "clearly and accurately" disclose to the employee that the report to be procured will include "information as to [the subject's] character, general reputation, personal characteristics and mode of living." *Id.*

244. *See* Fried, *supra* note 17, at 237.

245. Medine Letter, *supra* note 235.

ployer escape vicarious liability under *Faragher*.<sup>246</sup> "A vague or incomplete report by a [consumer reporting agency] will decrease the value of the investigation and the effectiveness of the employer's response to a harassment complaint."<sup>247</sup> Furthermore, a plaintiff in a wrongful termination action could easily challenge the report under *Cotran* since "[c]utting names and critical information out of the report just opens [employers] up to claims that the investigation is incomplete."<sup>248</sup>

## B. House Bill 4373

Another solution posed by the FTC is a legislative amendment proposed to the House of Representatives on May 3, 2000.<sup>249</sup> House Bill 4373 disposes of an employer's duties to provide notice to employees, obtain the accused's consent to proceed, disclose the report to the employee upon adverse action, and comply with some additional safeguards applicable for the use of the investigative report.<sup>250</sup> However, House Bill 4373 leaves intact all other FCRA requirements, such as the employer's obligation, in the case of adverse action, to provide the employee "the name and other identifying information about the [consumer reporting agency], and notification of the [employee's] right to obtain a disclosure of the [report's nature and substance]."<sup>251</sup> In the case of an investigative consumer report, the disclosure would include a "summary of the 'nature and substance' of the report," and would allow the employee "to obtain a degree of meaningful, genuine disclosure of the information that served as the basis for the adverse decision."<sup>252</sup> By failing to fully remove investigations of employee misconduct from the realms of the FCRA, House Bill 4373 only complicates the FCRA and inadequately rectifies the inconsistency between the FCRA and an employer's struggle to rid its workplace of misconduct.<sup>253</sup>

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246. See Fried, *supra* note 17, at 237.

247. *Id.*

248. *Id.*

249. See H.R. 4373, 106th Cong. (2d Sess. 2000).

250. See Fried, *supra* note 17, at 237.

251. *Id.*

252. FCRA Hearing, *supra* note 174 (statement of Debra Valentine, General Counsel, Federal Trade Commission), available at <http://www.house.gov/banking/5400val.htm>.

253. See Fried, *supra* note 17, at 239-40.

### C. House Bill 3408

House Bill 3408 was introduced in the House of Representatives on November 16, 1999.<sup>254</sup> It is an amendment to the FCRA that would exclude from the definition of "consumer report" all investigative reports regarding workplace misconduct and also those reports prepared in anticipation of litigation.<sup>255</sup> This amendment, in effect, creates a "blanket exemption" for investigations of employee misconduct from the requirements of the FCRA.<sup>256</sup> However, before taking adverse action against an employee on the basis of an investigative report prepared by an outside agency, the employer must still "disclose to the employee the nature and substance of the information in the report on which the proposed adverse action is based."<sup>257</sup> Thus, the FCRA requirements, even under House Bill 3408, would still extend to investigations of employee misconduct.

Although the two proposed amendments to the FCRA do exempt investigative reports of workplace misconduct from most of the provisions of the FCRA, they still require employers to comply with some lesser protections afforded by the Act.<sup>258</sup> The effect of either amendment, if enacted, "would be to foster a piecemeal attempt of providing statutory protection for an employee terminated or demoted on the basis of a false or unsubstantiated harassment complaint against him or her."<sup>259</sup>

## VII. Solution

As soon as what constitutes an adequate investigation is further defined by case law in California, employers will feel more secure in their decisions to terminate employees based on allegations of employee misconduct. However, a change must occur that will exempt employers from having to comply with the strict notice, consent, and disclosure requirements of the FCRA when conducting investigations of workplace misconduct. If Congress decides that an amendment to the FCRA is in order, then it should consider an amendment that would exclude from the FCRA "all employer investigations that in-

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254. See Fair Credit Reporting Amendments Act of 1999, H.R. 3408, 106th Cong. (1st Sess. 1999).

255. See *id.*

256. See Fried, *supra* note 17, at 239.

257. Fair Credit Reporting Amendments Act of 1999, H.R. 3408, 106th Cong. (1st Sess. 1999).

258. See Fried, *supra* note 17, at 241.

259. *Id.*

volve, as subjects or witnesses, any employee currently employed by the employer.”<sup>260</sup> In the employment context, the FCRA should apply only to consumer reports acquired by the employer used to make the initial decision of whether or not to hire the prospective employee.<sup>261</sup> This would further the purpose of the FCRA and would protect job applicants from an employer’s use of inaccurate and obsolete credit and credit-related information when making an employment decision.<sup>262</sup> If Congress does wish to extend protection to employees possibly wrongfully discharged on the basis of such investigative reports, it should enact law to that effect unrelated to the FCRA.<sup>263</sup>

However, even if Congress chooses not to amend the FCRA to explicitly exclude current employees, courts should be encouraged to construe the broad provisions of the FCRA narrowly “so as not to discourage an employer’s use of independent investigators.”<sup>264</sup> The language of the FCRA and evidence of legislative intent allow courts to resolve the dilemma posed by the Vail Letter by interpreting the FCRA as excluding investigations of workplace misconduct executed by third parties. Many outside investigators will not meet the definition of “consumer reporting agency” because their primary purpose is to provide legal advice to employers rather than compose “consumer reports” as defined by the FCRA.<sup>265</sup> Investigators arguably “do not prepare ‘consumer reports’ as defined by the FCRA, because the employer requests the report, not to investigate the employee’s credit-worthiness, character or reputation, but rather to determine and reduce potential employer liability.”<sup>266</sup> Thus, if interpreted by courts in a narrow fashion, the lingering conflict between employers and the FCRA can be eliminated.

## Conclusion

The *Cotran* decision was a necessary step which, as soon as the definition of “adequate investigation” is clarified through further litigation, will relieve employers of many unnecessary burdens when faced with allegations of employee misconduct. However, the Vail Letter places an unreasonable barrier before employers attempting to

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260. *Id.*

261. *See id.*

262. *See id.*; *see also* Robinson v. Time Warner, Inc., 187 F.R.D. 144, 147–48 (S.D.N.Y. 1999).

263. *See* Fried, *supra* note 17, at 241.

264. *Id.* at 240.

265. *See id.*

266. *Id.*



both perform adequate investigations and escape vicarious liability by using outside investigators. The "legislative history of the amendments to the FCRA indicates that Congress was . . . aware of the [effect the act would have on criminal or misconduct investigations] yet decided not to adopt a provision exempting employers from the requirements of [the act] when obtaining consumer reports on employees suspected of criminal activities."<sup>267</sup> However, Congress must be convinced that the consequences are against public policy and that the effects of the FCRA must be adjusted.

In order for *Cotran* to be fully effective, California employers must have the ability to freely obtain unbiased and experienced outside investigators to decipher and fairly assess allegations of misconduct within the workplace. It is therefore necessary for Congress to enact another amendment to the FCRA explicitly exempting investigations of employee misconduct from its guidelines and restrictions. It is contradictory for the state and federal governments to require effective, unbiased investigations of employee misconduct, while putting restrictions on the most effective and trustworthy methods of such investigations—the utilization of outside parties. Until Congress acknowledges this dilemma, courts should be encouraged to disregard the Vail Letter and construe the applicable terms of the FCRA narrowly so as to not hinder employers' use of outside agencies to conduct their investigations of employee misconduct.

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267. Sidney R. Steinberg, *Fair Credit Reporting Act Can Apply to Sex-Harassment Investigations: FTC Says Law Firms that Investigate Are "Consumer Reporting Agencies"*, THE LEGAL INTELLIGENCER, Sept. 8, 1999, at 7.

